Testimony

of

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before the

Senate Committee on
Commerce, Science, and Transportation

on

Cable Rates

July 28, 1998

Although Congress gave the Federal Communications Commission (FCC) the responsibility to hold cable television rates to a reasonable level until effective competition to cable grows, prices charged by cable monopolies are spiraling out of control. According to the Bureau of Labor Statistics, (BLS) cable rates have risen about 19 percent since the February 1996 enactment of the Telecommunications Act.[6873]

This in an annual increase of about 8 percent, almost four-times the rate of increase for the overall Consumer Price Index (CPI)[0] during this time period. The average price for the most popular basic cable channels has jumped from $24.43 a month before passage of the Act, to more than $31 a month this year.[8132] Consumers Union[0] believes Congress must either press the FCC, or act on its own to put a lid on cable rates. As *USA Today* reports:

> For the third year in a row, the nation's 65 million cable subscribers are getting hit with an average 8% hike in their monthly bills.
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> The typical family now pays more than $31 a month for standard cable fare, up from $28.83 last year.
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> Operators, are using lax federal rules to raise rates by adding channels that few customers want and that sometimes cost companies nothing. They're charging consumers for expensive equipment that most can't use yet. And they're making customers subsidize construction of interactive phone and video services that can't be available to most for years. Once they are, some services--such as high-speed Internet--will be so costly that they'll appeal only to affluent videophiles and technophiles.[9882]

[6873] P. L. 104-104

[0] BLS Consumer Price Index for All Urban Consumers

[8132] See Appendix A

[0] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about good, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 4.5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[9882] See Appendix A.

Between 1986 and 1992, when the cable industry functioned as a totally deregulated monopoly, cable rates adjusted for overall inflation increased at a slower pace--about three-times inflation--than they have since passage of the 1996 Telecommunications Act.[0] Just last month BLS data show that cable rates rose seven times faster than the CPI. As the attached chart indicates, FCC regulation held cable rates in check until the Commission relaxed its rules in late 1994, and then virtually abandoned oversight of the cable industry after passage of the Telecommunications Act. See Table 1.

Had competition developed in a manner that disciplines cable pricing, the FCC's failure to respond to these extraordinary rate increases might be understandable. However, after presiding over a cable en banc hearing last December, and after releasing a detailed report on the cable industry in January, Chairman Kennard acknowledged that competition has not developed at an adequate pace to eliminate the need for regulatory intervention:

> …less than 15 months away from the sunset of most cable rate regulation, it is clear that broad-based, widespread competition to the cable industry has not developed and is not imminent. Eighty-seven percent of those who subscribe to multichannel video programming receive service from their local cable operator…DBS…remains primarily a high-end product or a way to receive multichannel video service in areas cable does not reach. And while at least one local exchange carrier is beginning to provide cable service, telephone companies have not, on the whole, entered video markets on a widespread basis.
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> The loser is the American public. They must pay the higher cable prices yet they have few competitive choices. Policymakers should no longer have high hopes that a vigorous and widespread competitive environment will magically emerge in the next several months to reverse the troubling increase in cable rates.
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> The Commission's own rules and policies may be a source of this problem. We need to examine whether there are targeted adjustments that should be made to our rate rules. For example, our rules allow programming cost increases to be passed on to subscribers. But is this right? Should the consumer shoulder all the increased costs of programming, instead of sharing these costs among other revenue sources, such as advertising, commissions, and in some circumstances,

[0] Multi-Channel Video Competition Hearing before the Senate Committee on Commerce, Science, and Transportation, Statement of Gene Kimmelman, April 10, 1997

payments from programmers themselves, especially where these other revenue streams may have grown since the benchmark rates were set?

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Maintaining regulation as a surrogate for competition, and only until such time as competition arrives, is consistent with the historical underpinnings of federal regulation of cable television and reaffirmed by the Telecommunications Act of 1996. Yet, I do not believe that, come March 1999, the consumer will be able to rely on a competitive market to ensure reasonable prices and choice.[7]

Given this pessimistic view of the pace of competition, and acknowledgment of the need for regulation to hold down rates, it is astounding that in the more than six months since this statement was made, Chairman Kennard has done virtually nothing to adjust the Commission's rules to protect consumers from skyrocketing cable rates. As the *Washington Post* described an interview with Chairman Kennard:

Consumers looking for relief from rising cable TV bills won't be getting it any time soon from federal regulators.

Though he declared earlier this year that "cable rates are rising too fast," the head of the Federal Communications Commission said yesterday that his agency won't step in to freeze or roll back cable prices before a congressionally ordered deregulation of cable prices kicks in next March.

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"We're running out of time" to enact new regulations, Kennard said. Besides, he added, "it doesn't make a whole lot of sense for us to try and create a whole new regulatory regime only to have deregulation in March 1999."

* * *

Kennard said he isn't exactly sure why rates are rising so fast… Without drawing conclusions, he said the problem probably has several facets, including the rising cost of producing programs. He added that the regulations themselves may be to blame because they gave the industry too much latitude to raise prices.[8]

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[7] Statement of FCC Chairman William Kennard, In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, Jan. 13, 1998 (footnotes omitted)

[8] Paul Farhi, "FCC Chief Declines To Curb Cable Prices," *Washington Post*, May 15, 1998

This backtracking on the need to adjust cable regulations by Chairman Kennard is nothing short of irresponsible. After:

1) identifying the very conditions Congress stated were the basis for putting a lid on cable rates – lack of effective competition;

2) determining that where there is head-to-head competition cable rates are 12-20 percent lower than where the Commission's existing regulations control pricing;[12758]

3) finding that cable companies were gaining about as much revenue from increased advertising as they were paying for programming – a virtual revenue "wash;"[0] and

4) determining that about one-half of the most popular cable programming channels are owned by the very cable companies that are jacking up program prices,[0]

how can the Chairman of the FCC suggest that it is appropriate to do nothing to protect consumers against price gouging?

If the Commission simply lacked the resources to begin investigating how the cable industry has been taking advantage of consumers, a quick review of the daily press may have left the FCC ready to update its regulations long ago. For example, in January, The Economist identified how programming price increases often involve an internal cash transfer between a program-affiliate of a cable company and the cable company itself:

> Certainly, the cost of television programming has rocketed, with stars from such programmes as "Seinfeld" charging huge fees. But since TCI and Time Warner, the two biggest cable companies, make 23% and 12% of cable programming respectively, their plea sounds self-serving. Indeed, the regulators worry that programme-making cable companies, which are obliged to make their programming available to their competitors, are loading system costs on to their production arms, thereby passing them on to satellite broadcasters and other cable operators. The price of programming made by the cable companies rose by 16% last year, whereas the price of programmes made by the broadcasters rose by only 4%.[0]

[12758] Fourth Annual Report, In the Matter of Annual Assessment of the Status of Competition in Markets for the delivery of Video Programming, CS Dkt. No. 97-141, Jan. 13, 1998 at 97-106; Report on Cable Industry Prices, MM Dkt. No. 92-266, Dec. 15, 1997 at D-5

[0] Fourth Annual Report at 19-20

[0] Fourth Annual Report at 90-91

[0] "Cable's Hold on America," The Economist, January 24, 1998

Then on March 16, 1998, *USA TODAY*'s lead business story, "Cable's cash cow," offered a detailed analysis of the cable industry cost structure and revenue stream, which should have provided the FCC a road-map for how to update its regulations (see Appendix A). In dissecting one cable industry argument after the other about why rates are going up, this article reveals the following assessment from Wall Street analysts:

> "The vast majority of cable systems hold monopoly franchises resulting in no direct cable competition," a Merrill Lynch report concluded in late 1997. DBS, the investment firm said, "is also the highest-cost provider serving upper-tier subscribers. As a result, cable operators are generally able to maintain pricing during difficult times."

> "The market decided that government policies were a failure, and competition presents no risk to cable now and in the foreseeable future," Sanford C. Bernstein analyst Tom Wolzien says.

> "It [cable ownership of programming] creates an odd paradigm," says Bruce Leichtman of The Yankee Group, a research and consulting firm. "It's kind of a shifting from one pocket to the next."

USA TODAY's analysis concludes that cable "operators pad channel lists to pad bills," and warns: "Don't believe companies when they try to pass the buck for recent rate hikes. They are responsible. They're taking advantage of lax government regulations – and you." If *USA TODAY* could figure this out, why can't the FCC?

Two very important things have happened since Consumers Union testified before this committee last year, asking Congress to press the FCC to put a lid on cable rates until the agency promotes enough competition to give consumers a meaningful choice in the marketplace.[0] First, the pace of rate increases, adjusted for inflation, has accelerated. Second, the FCC has failed to begin a meaningful process to deal with cable price gouging and anti-competitive practices.

Consumers Union therefore believes it is long past time for Congress to take a lead role in reigning in cable industry abuses. We urge you to take whatever steps are necessary to make the FCC do its job to protect cable consumers, or provide another

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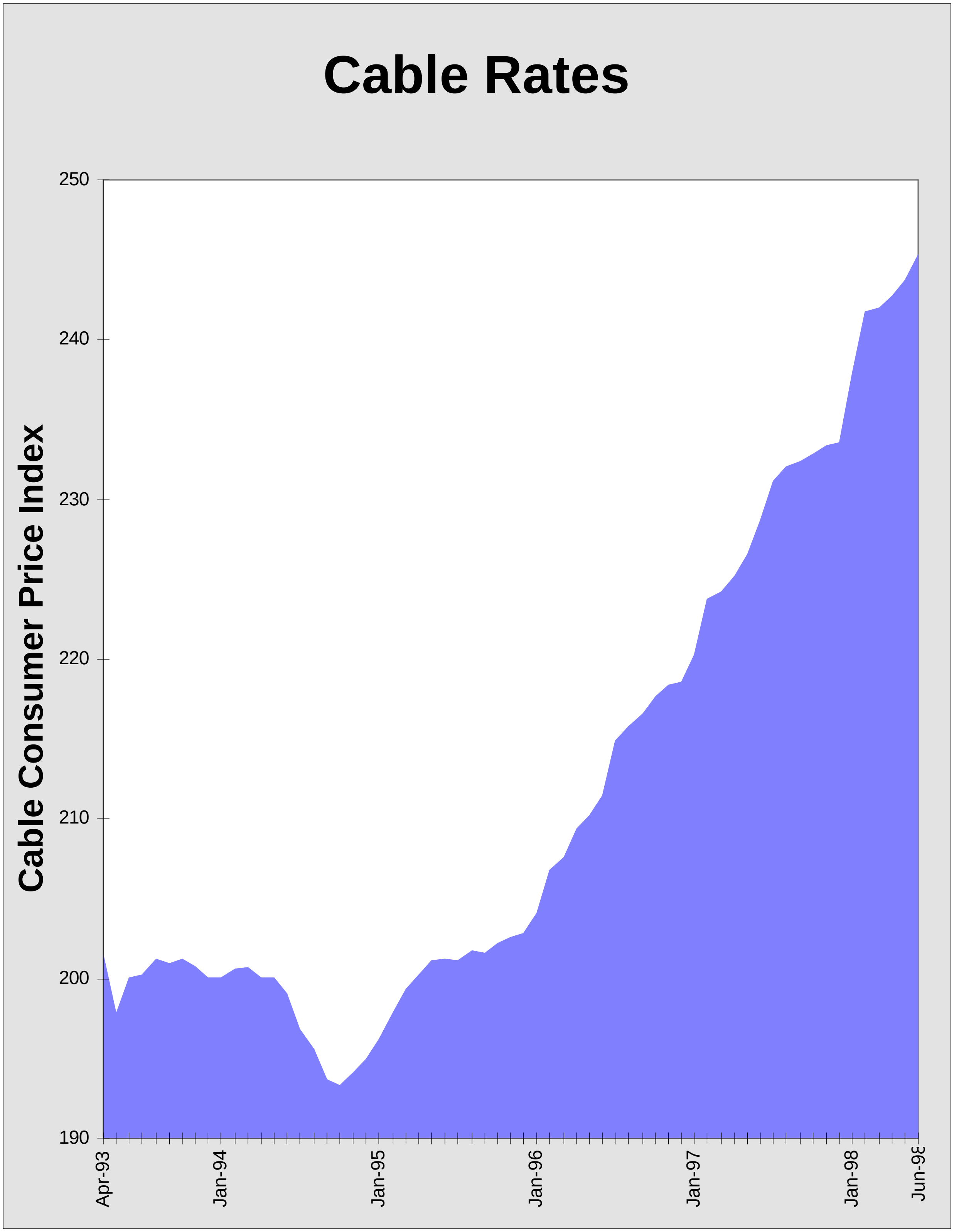
[0] Multi-Channel Video Competition Hearing, op. cit.

mechanism that promotes more competition and ensures reasonable cable prices for consumers.

Assistant Attorney General for Antitrust, Joel Klein, recently concluded that the cable industry "is one of the most durable and powerful monopolies in this country."[1] Only a lid on cable rates, until competition develops, will protect consumers from today's skyrocketing cable prices.

[1] John R. Wilke, "Antitrust Suit filed to Block Primestar Purchaser," *Wall Street Journal*, May 13, 1998

TABLE 1


Cable Rates
Cable Consumer Price Index
250
240
230
220
210
200
190
Apr-93
Jan-94
Jan-95
Jan-96
Jan-97
Jan-98
Jun-98